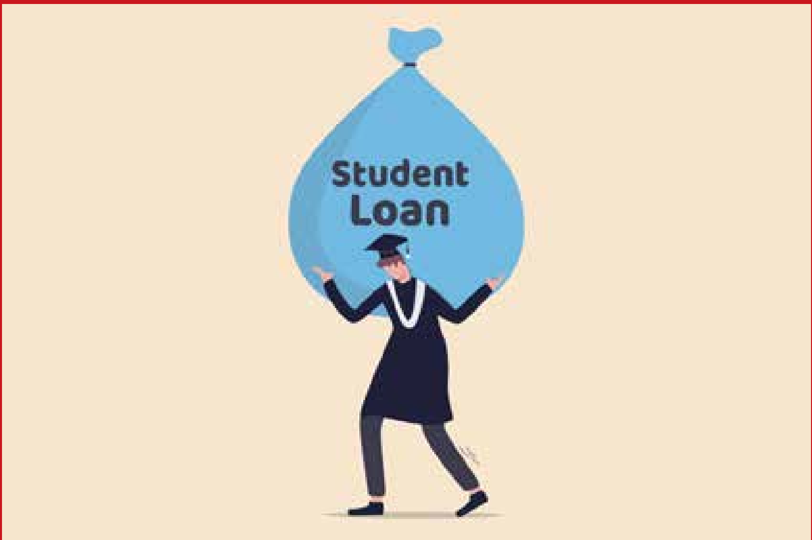
Student Finance in England from 2012 to 2020: From fiscal illusion to graduate contribution?

Alan Roff



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Debate Paper 25

About the author

For 37 years, Alan Roff lectured, researched and managed at the University of Kent, Kingston University and the University of Central Lancashire, where he was Deputy Vice-Chancellor from 1996 until his retirement in 2011. He therefore had first-hand experience of the arguments and outcomes underpinning the seismic changes in the volume and funding of undergraduate education in the years leading up to the 2012 changes.

Alan has a BA in Mathematics from the University of Oxford, an MA in Quantitative Social Science from the University of Kent and an Honorary Doctorate from the University of Central Lancashire. He has been a member of the Finance and Resources Committee of the University of Salford since 2015 and became a member of the University Council in 2019.

In recognition of the benefit he gained from his state-funded higher education in the early 1970s, he would be happy to pay a graduate contribution.

Acknowledgements

I should like to thank Professor David Miles for his advice and encouragement over the last 10 years. Without this support, I would never have completed this paper. I am also grateful to Nick Hillman for challenging me to justify many arguments and statements. His challenges have helped me to improve the clarity and accuracy of the paper. Finally, I am indebted to all those who were kind enough to comment on earlier drafts of this paper. The responsibility for any errors is mine alone.

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Foreword

Nick Hillman, Director of HEPI

Student finance has been strongly contested for decades. In the mid-1980s, the Conservative Government had to perform a dramatic u-turn after proposing the reintroduction of student fees – though this did not stop Margaret Thatcher's last major social reform being the implementation of maintenance loans in 1990.

Subsequently, John Major's Government contracted out the tricky question of how to introduce a more sustainable system of higher education finance to a review that reported in 1997 and which was led by Ron Dearing (later HEPI's first Chair). The first New Labour administration responded by introducing £1,000 means-tested fees in 1998. Its successor, the second New Labour administration of 2001 to 2005, legislated for higher fees capped at £3,000 for England. This took effect during the third New Labour administration of 2005 to 2010, which also set up a review of higher education funding under John Browne.

After receiving the Browne report, the new Coalition Government famously tripled the full-time undergraduate fee cap in England to £9,000. This decision, which is the focus of the pages that follow (and in which I played a minor part), was designed to put more of the total costs of educating undergraduates on students' own shoulders, with the debt still being repaid via income-contingent loans after graduation. The progressive repayment terms meant, however, that students would, on average, end up paying back quite a lot less than they had borrowed – and, as it quickly became clear, more than originally forecast would need to be written off by taxpayers.

The increase in fees was largely designed to help reduce the deficit in the UK's national accounts at a time of wider retrenchment. Money loaned to students did not count as current public spending, so swapping grants to institutions with higher student loans produced big savings in the numbers. There were other goals of the reforms too, such as reducing funding pressures on hard-pressed institutions and ensuring a future healthy supply of student places.

HEPI was the first organisation to question whether the new system would end up saving the Government money on educating each student in the long-term. As the following pages remind us, the student loan repayment terms meant that – even though the average debt of each student was going up and the maximum repayment term was being lengthened from 25 to 30 years – graduates' monthly repayments would reduce. The final net tally of sums lent and sums repaid depends on how well graduates do financially during the first three decades of their working lives, which is notoriously difficult to estimate.

The question of whether money would be saved through the changes took on renewed importance afterwards. One of the first decisions of the Conservative Government elected in 2015 was to spread the principles already applied to tuition to living costs. Maintenance grants disappeared, replaced by larger loans, meaning average student debt grew further. As a result, the proportion of student debt projected not to return to government grew as well.

Theresa May responded to the apparent (but disputed) influence of students and young graduates on the close 2017 general election result by introducing a large one-off increase in the student loan repayment threshold to £25,000. This meant graduates would repay back even less of what they had borrowed and even more of them would reach the end of their repayment terms with significant sums that would need to be written off by taxpayers. At the same time, May announced a review of post-18 education, which became the Augar review.

It is a complex story that may still have a final chapter to come. On the one hand, the broad outlines of the post-2012 system remain in place nine academic years after they were first introduced, having survived the Opposition's commitments to abolish tuition fees at both of the last two general elections.

On the other hand, the accountants have decided that an estimate for the large student loan write-offs should now appear in the national accounts at the point student loans are taken out. Their view is that 'loans' which are expected, in large part, to be written off should not actually be treated as repayable loans. With the stroke of a pen, this adds billions of pounds to annual public spending, which has also seen huge unsustainable increases due to COVID-19.

There are three main ways to respond to this technical but important accounting change.

i. Firstly, keep the current student funding system – perhaps on the grounds that the substantial public spending on subsidising higher education is more than recouped by extra income tax payments from graduates as a result of their higher education.

ii. Secondly, reform the current system – for example, by making graduates repay a higher proportion of their total debt (perhaps through a lower repayment threshold or a longer repayment period or reducing fees, all of which were recommended in the Augar report) and / or renaming the system to remove the problematic language of 'fees', 'loans' and 'debt'.

iii. Thirdly, reject the current system and introduce something completely different, such as funding higher education through general taxation or a new graduate tax.

In the pages that follow, and in an accompanying Appendix available on the HEPI website, Alan Roff proposes a model that lies somewhere between the second and third of these options but which veers towards the more revolutionary end of the spectrum.

He proposes a new graduate contribution scheme that has some elements in common with the current system but which would aim to be more transparent about the sharing of costs and seek to recover higher payments from those graduates who do best financially in the labour market. Roff's goal is to remove the concept of debt while continuing to expect graduates to contribute financially to the costs of their own higher education.

He additionally raises the prospect of some more radical features, such as imposing new costs on people who graduated long ago and before the current fee regime was instituted (like

Alan Roff himself), which would make the model even more novel. He even floats the idea of closing the Student Loans Company.

Roff regards change, sooner or later, as an 'inevitable' consequence of the current tensions inherent in the funding system that England has chosen. He pithily argues that, 'it is not sustainable to retain a loan and debt repayment system in which loans are not loans, debts are not debts and repayments are not repayments'.

Many people will agree, but others will disagree with his diagnosis and / or his prescription and may instead regard the current system as an acceptable compromise balancing competing priorities. That difference of opinion is in the growing tradition of HEPI's Debate Papers, which have recently covered such contested issues as academic selection, decolonising the curriculum and how universities should address climate change.

While the focus in the pages that follow is primarily, though not entirely, on England, the ideas are relevant across the UK, as higher education finance continues to be fiercely debated in Scotland, Wales and Northern Ireland as well as at Westminster.

Indeed, given the state of the finances at some Scottish, Welsh and Northern Irish higher education institutions and the forthcoming devolved elections in these three areas of the UK, some might feel the arguments could prove even more pertinent there.

Executive summary

This paper looks at the crisis in university finance identified by the recent financial analyses of the Office for Budget Responsibility and the Office for National Statistics and puts forward options for the future.

In December 2019, the Office for Budget Responsibility (OBR) concluded that student finance in England (and the 2012 student loan scheme on which it rests) is based on a 'fiscal illusion'. The Office for Budget Responsibility accept that 62 per cent of the total of loans being made to students will never be paid back and that only 17 per cent of graduates will fully repay their loans. As a consequence it concludes that, ever since 2012, the UK has falsely accounted for student loans in the national accounts and must, as a result, increase the reported cost to the Exchequer by £56 billion immediately (Financial Year 2018/19). Thereafter, the increase in costs to the Exchequer will rise by around £15 billion each year to reach a cumulative total increase of £128 billion by 2023/24. This leaves the current scheme for financing higher education in ruins. Its rationale for existence, its financial outcomes and even its terminology are untenable.

The paper goes on to look at the way the scheme was introduced and the way that the Government allowed its enthusiasm for reducing the public sector deficit to lead it to ignore clear advice that the scheme was financially unsound.

It ends with a discussion of the options for student finance in future. It sets out an argument that the current scheme cannot be 'fixed' in any way which is politically or economically effective. It then goes on to demonstrate that a hybrid scheme involving financing undergraduate education by a more even balance of grants and loans, such as the scheme recommended by the Augar report in 2019 or the scheme which prevailed in the UK from 2006 to 2012, would inevitably face the same financial difficulties.

It concludes that, unless there is support for a scheme wholly funded by taxation, there are overwhelming financial, political and educational advantages to government, political parties, students and the wider population (except for the highest paid graduates) in replacing the current scheme with one which is partially funded by a graduate contribution scheme.

The final sections look at how such a scheme could be implemented in a way that would place a reduced burden on the Exchequer but would wipe out individualised student debt and place university finance on a far sounder basis for the future.

However, for such a scheme to be adopted, it would require a clear case to be made from within the sector to ensure that this occurs. Unless this case is made, there could be considerable problems for universities, students and graduates in future.

1. Reclassifying loans – at a cost of £12 billion per year

1.1 On the morning of Friday, 13 December 2019, the day after the general election, the Office for Budget Responsibility (OBR) put a report on its website which, when read alongside an Annex to its *Economic and Fiscal Outlook* from March 2019, fundamentally changed the way the 2012 student loan scheme for English higher education students would be treated financially.[1] If ever there were a day to bury bad news, this was it. Although its contents were hugely significant, the report received very little attention. The two Office for Budget Responsibility documents state that the 2012 student loan scheme was – and always had been – based on the 'fiscal illusion' that the loans made to students from England to pay for the £9,250 (per annum) fee and living expenses would be almost entirely repaid. In fact, the OBR now calculated that only 17 per cent of former students would ever fully repay their loans. The scheme had always included the proviso that, after 30 years, any remaining loan owed by a graduate would be 'written off' (repaid) by the Treasury, leaving the ex-student debt free at last. It had never before been officially admitted that this government write-off would affect 83 per cent of former students and would have to cover 62 per cent of the total amount loaned. A typical student on a three-year degree would therefore pay just one year of the cost of their degree, with the other two years of costs falling on the public purse. The Office for Budget Responsibility also admitted that it would no longer be financially acceptable to describe the money 'lent' as 'loans' given that so little would actually ever be repaid.

1.2 In terms of the overall economic effect, the obligation to write off such a large amount of student debt led the Office for Budget Responsibility to conclude that Public Sector Net Borrowing (PSNB) had been systematically understated by several billion pounds each year since 2012. By 2018/19, the annual impact on Public Sector Net Borrowing (associated with the cohort of students entering in September 2018) had reached £12 billion; while the cumulative understatement of the cost to the Exchequer caused by the 2012 Student Loan Scheme had reached £56 billion. By 2023/24, the annual addition to Public Sector Net Borrowing would reach £15 billion and the cumulative additional cost falling on the Exchequer would reach £128 billion. (To give an idea of the scale of this cost, £128 billion is close to the annual cost of the NHS.) The additional annual and cumulative costs to the Exchequer would continue to rise for as long as the scheme remained in force.

2. The Office for Budget Responsibility report

Looking more closely, there were at least four interesting features of the Office for Budget Responsibility report.

2.1 The language in the report was unusually stark. One does not often see a government scheme, which has run and been staunchly defended for 10 years, being described as 'bedevilled by fiscal illusions'.

2.2 The numbers in the report are astonishing. In particular, as stated above, the Office for Budget Responsibility tells us that the medium-term cost of the scheme had been understated by £128 billion and would continue to grow at £15 billion per year. This is a scheme designed as part of austerity measures introduced in 2010 (by the Conservative / Liberal Democrat Coalition Government) to reduce the cost of higher education to the state. These Office for Budget Responsibility figures make clear that the 2012 scheme actually significantly increased that cost (probably by around 25 per cent depending on assumptions made).

2.3 The report is refreshingly clear and detailed in its analysis of macroeconomic implications. For example, it recognises that, within the National accounts:

> *The subsidy cost of student loans is understated for decades while the beneficial effect on revenue is overstated for decades, so that they flatter the headline budget measure. And their value as government assets is ignored in the headline net debt measure, but overstated in the broader net financial liabilities measure*.

Moreover, the Office for Budget Responsibility recognises that student loans do not comply with the European System of Accounts (ESA) 2010 definition of a loan, which requires full repayment at maturity. Describing them as loans therefore misrepresents the government's true financial position.

2.4 Despite the above, the information in this report was not new. The fiscal illusion had been officially recognised by the Office for National Statistics in 2018.[2] Moreover, all of the key figures were in line with those produced by independent analyses of the scheme over the nine years since its introduction (and indeed even before the scheme was introduced in 2012).[3] Although the Treasury had originally placed the Resource Accounting and Budgeting (RAB) charge, which is the percentage of debt for which the Exchequer would be liable, at 30 per cent in the early years of the scheme, most independent analyses carried out before the scheme was introduced had placed it closer to 50 per cent and the consensus level has moved gradually upwards ever since. In this context, the 'new' 62 per cent RAB will not cause any surprise to those who have looked carefully at the scheme.[4] Likewise, it was always recognised by those who understand national accounts that the effect of student loans not being fully repaid on government borrowing would inevitably have to be admitted sooner or later. Within the higher education sector, it was widely recognised that, because such a large proportion of the so-called loans would never be repaid, this was in reality more like a graduate tax than a student loan scheme and was essentially 'sold' on that basis to students from day one.

3. Crisis or opportunity?

3.1 In summary, then, the 2012 student loan scheme had already widely been recognised as an expensive anachronism. The Office for Budget Responsibility now officially recognises this. It is clear from published exchanges between the Office for Budget Responsibility, the Office for National Statistics and Eurodata (the European counterpart of the Office for National Statistics) that this is now as 'official' as it can get.[5] As argued below, the scheme is so flawed that there is no realistic way in which it could be revised to make it workable. In normal times, the Office for Budget Responsibility report may have prompted calls for a new scheme to be introduced to govern student finance in England. However, these were not normal times. The rush to get Brexit 'done' before 31 January 2020 ensured there would be no immediate discussion of student loans. Since then, the COVID-19 crisis has further delayed any consideration of the issue. However, the widespread calls for student fee refunds in the light of the 2020 student experience under COVID-19 restrictions will create a very different context for that consideration. This and the possible economic impact of COVID-19 and Brexit on the prospects of all those born in the 21st century paradoxically may help to ease the way to creating a consensus on the way forward. There is therefore now an opportunity to look at what might be the characteristics of a new scheme. We will turn to this in section 5 but, before doing so, it is worth looking (in section 4) at how the scheme came about and why it has been allowed to continue for so long. This is covered in more detail, in an Appendix available on the HEPI website.[6]

4. How did we get here?

4.1 In the Appendix, we look in detail at the introduction and development of the English student loan scheme but the main points are summarised here.

4.2 The Anderson report of 1960, which fed into the Education Act (1962), set the framework for the next 35 years in which full-time undergraduates received means-tested mandatory grants to cover tuition fees and living costs while studying at university level.[7] Although the means-tested element resulted in better-off parents making a significant contribution to overall costs, undergraduates themselves received a higher education and living costs free of charge while studying and without any payment after graduation (until 1990, when maintenance loans were introduced for part of those costs). Part-time undergraduate and all postgraduate education attracted a fee as a contribution to costs, the remainder of which were topped up by the state. As costs grew with the steady increase in the percentage of 18-year olds proceeding to higher education, a call for graduates to contribute was increasingly being made. A National Committee of Inquiry into Higher Education, chaired by Sir Ron (later Lord) Dearing, was commissioned by the Government in 1996 and produced the Dearing report in 1997.[8] This comprehensive 466 page report recommended a fee of £1,000 a year for an undergraduate as a way of injecting more funds into higher education institutions but also in recognition of the cost to the Exchequer of the increased number of students. At the time, this was seen as a significant change, even though the fee represented only around 25 per cent of the full cost of providing degree-level study. Dearing recommended that the £1,000 fees should be loaned to students with repayments made on an income-contingent basis after graduation, while living costs should continue to be covered by a mixture of grants and loans. These Dearing principles were eventually conceded in 2003 in a White Paper published by the Secretary of State for Education and Skills, Charles Clarke, but only after a period of a few years during which one of his predecessors, David Blunkett, had instead made the £1,000 tuition fee payable up-front (subject to means testing) and had abolished maintenance grants in favour of higher maintenance loans to be repaid income-contingently after graduation.

4.3 The Higher Education Minister, Alan Johnson, raised the fee to £3,000 a year for undergraduates entering higher education from 2006. Universities would continue to receive a grant on top of the fee received from the student so that the total amount they received per student was more than twice the fee and would reach around £7,000 a year on average (more for Science students; less for Humanities students) by the time the Browne review reported in 2010.

4.4 The Dearing and Johnson reforms introduced by the Labour Governments left a legacy for the future by establishing individualised debts for each student to cover part of the costs of their studies. On graduation, these would render them liable to make income-contingent loan repayments determined by the income of the graduate and not the level of debt. The repayment was (and still is) 9 per cent of a graduate's income above a given salary threshold (set at £15,000 a year in 2005) regardless of the level of debt. Repayments would be collected through the HMRC Pay As You Earn scheme and would continue until the debt had been fully repaid (or until 25 years after graduation, whichever was the sooner). This made the repayment basis very different to that used for a mortgage where the level of repayment varies with the amount borrowed but also very different to income tax (in that income tax does not cease to be levied after a citizen has paid off their 'share' of government costs).

4.5 Soon after the 2008 financial crash, the Labour Government established the Browne review in 2009 to investigate and make recommendations on the funding of undergraduate higher education. By the time its report was published in October 2010, a general election had taken place, resulting in a new Conservative / Liberal Democrat Coalition Government. This initiated a radical austerity programme designed to effect huge and immediate cuts in public expenditure. It should therefore be recognised that the scheme was very much a creature of its time.

4.6 The Government welcomed the Browne report which seemed to offer an opportunity to transfer almost all of the cost of English higher education from the state and instead to place the burden on students as graduates.[9] The Government adopted the basic recommendation of the Browne review to replace the existing scheme (which used a combination of fees and grants to students and universities) with one based on very substantial loans to students from which they would cover the cost of their higher education (apart from some residual grant funding from the Higher Education Funding Council for England, for disciplines that are more expensive to teach). With few significant modifications (particularly the introduction of a maximum fee which inevitably became the standard fee for virtually all courses and universities), the

Government followed the recommendations in the report to produce a scheme which would treble the prevailing annual undergraduate fee from £3,290 to £9,000, extend the loan period then in place from 25 to 30 years and yet significantly reduce the payments made each year by graduates compared to the pre-2012 scheme. The repayments would however continue to be set on an income-contingent basis (at 9 per cent of income in excess of the new higher threshold of £21,000 a year) regardless of the actual level of debt. Browne therefore retained a progressive approach towards setting graduate payments. Browne recognised that one impact of this progressive approach was that some graduates would never fully repay their loans and an allowance was made for this in the original Treasury calculations to cover the cost of writing off 30 per cent of the value of all loans at the end of the 30-year repayment period. However, this allowance was not carried over to the way that the scheme was treated in the national accounts. For these, student loans continued to be treated as if they would be fully repaid in line with the definition of a loan set out in 2.3 above. (This had not been a significant issue in the 1998 or 2006 schemes because the loan values were far lower – even in real terms – and the repayment thresholds were also set much lower so that the level of repayments was much higher. Consequently, it was only when the 2012 scheme came into force that non-repayment of loans became a major issue.)

4.7 To compound the problems which would arise due to the way that student loans were treated in the national accounts, there were two significant erroneous assumptions underpinning the financial estimates used in official costings of the scheme. Firstly, the graduate salary growth projections were far too optimistic. As graduate income determines the level of income-contingent loan repayments, the figures seem likely to have significantly overestimated the revenue which would be received from graduates over the 30-year repayment period. Secondly, the average fee level charged by universities was underestimated by 20 per cent.[10] As a result, the average student loan and the resultant cost of the scheme were also significantly underestimated. Independent analyses were therefore able to demonstrate that a huge gap between the cost of the scheme and the level of loan repayments was bound to open up. Despite the analysis showing that this would lead to around half of the total student debt not being repaid within the 30-year limit (and therefore instead falling back on the public purse), it went ahead and installed the scheme. Although there was an implicit recognition by the Conservative / Liberal Democrat Coalition Government that 30 per cent of all loans would need to be written off by the Treasury after 30 years, it continued, for accounting purposes, to treat all the loans as if they would be fully repaid by each graduate. This was the fiscal illusion which has lain at the heart of the scheme from its outset.

4.8 It is easy to see why this 'illusion' did not prevent the scheme coming into force, regardless of the findings of independent analyses (or indeed the effects on graduates of carrying debt which would typically be around £40,000 on graduation and often increased thereafter). One of the major benefits which the Government grasped was that, under standard accounting conventions, a fully loan-based scheme would enable it to reclassify the cost of higher education in the public accounts. Grants to universities and students counted as public expenditure. Loans to students did not. When fully operational, the new scheme was therefore projected, at a stroke, to reduce public expenditure by around £7 billion per year.

4.9 Changes to the repayment threshold have been made to the scheme since then but the basics remain unchanged. Taken as a package, those changes have actually increased the proportion of the debts which will have to be written off and which therefore will fall to the public purse.

4.10 The most significant and strategic attempt to modify the scheme was produced in the 2019 Augar report, which remained in the 'in-tray' of the Government at the end of 2020.[11] A detailed analysis of the proposals in the report is included in the online Appendix but we can summarise the Augar proposals as:

- reducing fees by 20 per cent to £7,500 a year from 2021/22, thereby reducing average student debt by more than 10 per cent;
- using government grants to higher education institutions to replace income lost through reduced fees;
- adjusting index linking and thereby slightly reducing the total funding of higher education institutions in real terms until 2022/23 but thereafter stabilising funding per student in real terms while also allowing growth in student numbers in line with demographic trends;[12]
- maintaining the split of costs between the student and the state;[13]

- redistributing the costs per student so that high-paid graduates pay less and lower-paid graduates pay more than under the 2012 scheme;[14] and
- redistributing expenditure within and between higher education institutions to ensure that Science and Engineering courses are better funded at the expense of Humanities, Business and Creative Arts courses.

4.11 Adopting the Augar recommendations would make no overall difference to the fiscal illusion identified by the Office for Budget Responsibility.[15] They would affect neither the total cost of higher education (except for a very short-term delay to index-linking the funding per student) nor the split of costs as a whole between the student and the state. However, Augar remains a significant document. If fully or partially implemented, it would materially affect the funding of students and institutions.

4.12 The Augar report demonstrates the problems which arise when one seeks to retain the basic principle of the 2012 scheme. This underlying principle, which fundamentally changed the basis of student finance in UK when it was introduced, is that the cost of higher education should be fully individualised into a debt which should be repaid by each individual student after graduation. This principle inevitably leads Augar to a range of fiscally regressive measures which attempt to make graduates on lower or middle range incomes make larger repayments (primarily by extending the payment period and lowering the salary threshold at which repayment commences) in order to maximise the contribution that can affordably be drawn from them to meet the costs of their higher education. However, Augar's proposed changes also ensure that high-paid graduates do not pay more than the cost of their education. Although the changes do generate some additional contribution from the less well paid, the restrictions of affordability make it impossible to generate sufficient additional revenue to make a significant difference to the split of cost between the state and graduates. Moreover, the protection of higher-paid graduates from additional payments reduces the revenue from the graduates who would be most able to afford to pay more, thereby leaving the total cost to the state unchanged. This outcome of repayments meeting less than 50 per cent of the total costs is not restricted to the specific proposals of Augar. It is an inevitable outcome of any attempt to modify the 2012 scheme while remaining true to the principle of making each graduate responsible for repaying their individualised debt through income-contingent loan repayments.

4.13 This is perhaps the appropriate point to make the observation that, as if by magic, the Dearing, Johnson, Browne and Augar schemes share the characteristic of being unable to generate revenue sufficient to meet more than 50 per cent of the costs of undergraduate education. There is, of course, no magic involved. Apart from some variation in the threshold income for repayments to commence and some variation of the term (25 years before 2012, 30 years after, 40 years proposed by Augar), all of the schemes collect similar revenue. Likewise, there has not been much long-term movement in the costs of undergraduate education. Prior to 2012, the costs were closely controlled by government. The unintended (but inevitable) consequence of the introduction of a maximum fee of £9,000 in 2012 was to bring about an increase in the unit of resource of around 15 per cent but this has since been clawed back through inflation by freezing the fee at £9,250 in cash terms. Looked at in the long-term and in real terms, the expenditure on undergraduate education per student has seen little change since 2000. Nor has the revenue collected per graduate changed much. So the percentage collected has also not varied much. Johnson and Dearing explicitly recognised the societal and economic benefits of having a highly educated population and accordingly never intended that their schemes would collect more than 50 per cent of costs. With costs and revenue broadly unchanged since then, the current scheme and that proposed by Augar will lead to a similar outcome. Economic and educational historians will look back in bemusement at why anyone believed in 2010 that the scheme to be introduced in 2012 would somehow cover a higher percentage of costs when the repayments remained broadly unchanged.[16]

4.14 This, of course, is why the 2012 scheme is, by its nature, not fixable. If one clings to the concept of individualised student debt and sets affordable repayments for graduates on an income-contingent basis, one can never generate the revenue necessary to meet more than 50 per cent of the total cost of undergraduate education. Affordability prevents us from significantly increasing the revenue from the overwhelming majority of graduates (currently 83 per cent) who already pay the income-contingent loan repayments for the full 30 years under the 2012 scheme; while the individualised nature of the debt means that those who could afford more – the highest paid graduates – cease to make a contribution after their individualised debt has been fully repaid.[17] Introducing the type of 'part-fee; part-grant' system proposed by Augar simply worsens the situation.[18]

4.15 Throughout the period in which the scheme has operated and within all of the minor changes either made by the Government up until 2018 or proposed by Augar in 2019, there has been one constant benefit that has protected the scheme from radical change. This benefit is the historic and projected savings to Public Sector Net Borrowing (PSNB), which entered the national accounts by deeming the scheme to be 'loan' based.

4.16 The Office for Budget Responsibility's report fundamentally changes the situation. The reversal of the Public Sector Net Borrowing effect will hit the national accounts in two phases. The first phase will be the reversal of the illusory savings made since 2012 for the first seven years of the scheme. The understatement accumulated up to 2018/19 of the cost to the Exchequer caused by student loans (almost entirely due to the 2012 scheme) is £56 billion and more than wipes out the total 'savings' claimed for the scheme since its inception. The second phase will be the reversal of the savings each year into the future as the true costs of writing-off loans has to be reflected in projections for successive cohorts of students entering higher education each year. These costs will raise the estimated requirement for public sector borrowing by around £15 billion each year into the future, again more than wiping out the apparent future savings made by the scheme. These are the figures reflected in the Office for Budget Responsibility report.

4.17 It is possible to find ways in which the statistical and accounting holes in the 2012 scheme can be more accurately reported for accounting purposes. While these will not in any way change the actual costs of the scheme (as revealed by the Office for Budget Responsibility), they will at least finally demonstrate the true costs to the Exchequer and officially expunge the illusion that the 2012 scheme has somehow reduced public sector borrowing. Achieving this improvement in accounting accuracy, however, has implications for transparency as shown in the methods which the Office for National Statistics (ONS) has recently announced.

4.18 In January 2020, the ONS published a report explaining how student loans will need to be treated in future.[19] The ONS has ruled that a 'partitioned loan transfer approach' should be used. Under this approach, loans made to students will, at inception, be reclassified in recognition of the fact that a large proportion of the so-called loan is actually a government subsidy in that it will never be repaid. So, of the c.£16 billion loaned to students by the Student Loan Company in 2019, over half will 'be deemed to have been cancelled at inception', with only the remainder treated as a real loan. The actual loan-to-subsidy ratio is to be estimated annually according to the current estimates of graduate salaries, interest rates and so on but will need to be consistent with the estimated Resource Accounting and Budgeting charge at maturity. This calculation and reclassification will be made for each year cohort of students (for example, the class of 2019) but not for loans for each student. So billions of pounds of student debt (over half the total) will be 'deemed to be cancelled at inception' but no individual student will have any of their debt 'cancelled at inception'.

4.19 In statistical terms, the approach of the Office for National Statistics is as straightforward as it was ever going to be possible to achieve. It squares the circle of correctly recording the majority of aggregate 'debt' as a subsidy (which must be recorded in the year that the 'loan' is made) and therefore not really being debt, while at the same time continuing to treat the whole of the debt of each individual student as if it continued to be debt without an element of subsidy. The former corrects the inaccuracy involved in falsely treating the whole of the amounts advanced to students as if they are fully repayable loans, while the latter enables the state to proceed as if the reclassification had not taken place when it comes to collecting the revenue from loan repayments from every graduate able to pay (income-contingently). It has to be done in this way as it will be 30 years until it is known what proportion of their debt any individual student will have been able to repay. Until the 30-year post-graduation period has elapsed, government prospective revenues will be protected by keeping the whole of every individual student's debt 'live' so that payments can be collected as if the whole of the moneys advanced were a loan. Only at maturity will some or all of the individual student's debt be 'deemed to have been cancelled at inception'. In the world of the 'partitioned loan transfer approach', the total debt recorded will be less than half of the sum of all the debts owed by individual students (assuming policy does not change).

4.20 One should not infer from the complexity of the solution from the Office for National Statistics that the key underpinning principle of the scheme (full-cost individualised student debt repayable by income-contingent loan repayments) or the key economic benefit (the huge consequent reduction of Public Sector Net Borrowing) have survived. The Office for Budget Responsibility report and the accounting treatment set out in the report of the Office for National Statistics each explicitly destroy both of these. Over 50 per cent of loans made each year will be identified as a subsidy which must be included at inception (up-front) in the national accounts. This adds £15 billion to the annual cost of the scheme. The Office for National Statistics's treatment also breaks the rigid link between the aggregate loan made to students and the debt repayments being made after graduation. This in turn makes it impossible to see the payments made by graduates as loan repayments. Firstly, it has been established by the Office for Budget Responsibility and the Office for National Statistics that the moneys provided to students were not loans. Secondly, the way in which income-contingent loan repayments are calculated (9 per cent of income above a threshold) makes it impossible to see the repayment level as being linked to the size of the loan given that it is independent of it. And thirdly, there is no longer any fixed link between the loan and the debt given the write-off of the majority of the debt at inception.

4.21 This raises a further question. If the payments made by an individual graduate cannot be regarded as loan or debt repayments, what are they? The limit on the repayments created by the cessation of such payments after an individual 'loan' has been fully repaid makes it hard to see the payments as a graduate tax. Instead, it is perhaps most accurate to regard the payments being made by graduates under the 2012 scheme as a graduate contribution. This term accurately captures the fact that there is no longer any pretence that repayments will fully cover all costs.

However, it also contains an ambiguity in that it leaves open the question of the purpose of the graduate contribution. Is the purpose of the graduate contribution to repay some or all the historic cost of the graduate's own higher education or is it being made to meet some of the cost of the cohort of undergraduates currently studying when the contribution is made? The former interpretation continues with the assumptions originally made under the 2012 scheme but the latter fits better with the timeline in which payments and costs occur. For practical purposes, of course, it makes no difference to the graduate which of these interpretations prevails in that HMRC will continue to collect the graduate contribution whatever it is called and whatever its purpose. One can only speculate as to whether an individual graduate would rather see their contribution as part-repayment of past expenditure on their education or as a contribution to ensuring that the next generation gets the opportunity for the benefits of higher education which the graduate themselves has gained.

4.22 The recognition that the payments made by graduates are more accurately regarded as a graduate contribution rather than a loan repayment or a graduate tax has a further effect. It undermines the case for the continuation of the infrastructure (including the Student Loans Company) needed to manage the loans, to impose debts on students and to manage their collection. If we are merely looking to deal with a graduate contribution which will be collected by HMRC, all of the loan infrastructure may come to be seen as just an unnecessary and expensive piece of bureaucracy.

4.23 Moreover, the financial infeasibility of the principle underlying the scheme and its main economic benefit makes it impossible not to recognise that there is one very clear implication from the last 10 years. The model of placing the full cost of higher education onto each individual student is not financially viable because there is no politically acceptable or financially affordable way of doing this which will lead to anything remotely resembling full debt repayment. (This, of course, is why no other European nation has adopted such a scheme.) To pretend to be able to do so is just a continuation of the underlying fiscal illusion. It is also why we have no choice but to consider other approaches even if these include options that have been rejected in the past.

4.24 What remains is a scheme stripped of its claim to be reducing Public Sector Net Borrowing. In reality, it has been shown by the Office for Budget Responsibility that it will have cost £128 billion more by 2023/24 than was originally reported in the national accounts. It is not financially effective in that it costs the Exchequer far more than the scheme it replaced. It is not socially desirable in that it will eventually result in up to 50 per cent of the working population carrying debts that they and government know can never be repaid in full. While one can respect the skills of the Office for National Statistics in producing a solution to restore reporting accuracy to the national accounts, it is not sustainable to retain a loan and debt repayment system in which loans are not loans, debts are not debts and repayments are not repayments. It is not prudent for a government to base its funding of higher education on the known fiscal illusion that underlies this scheme. We can and should do better than this. In the next section, we can look at the options by which this might be achieved.[20]

5. Options for the future

5.1 In considering options for the future, it is important to understand the full implications of the Office for Budget Responsibility report and the analysis above. Section 4 concludes that any scheme based on the individualised debt and graduate income-contingent loan repayment model is not viable and will always result in the sorts of outcome summarised in 4.24 above. Attempts to 'fix' this model are doomed to failure. The limits of affordability for the overwhelming majority of graduates, who currently never fully repay their debts under the current scheme, and the limits created by individualised debt, which enable the highest paid graduates to cease payment immediately their individual debt has been repaid, constrain the revenue that can be collected. It is necessary, therefore, to look at alternatives which are not based on this model.

5.2 As soon as one accepts this, however, there remain really only two options for funding undergraduate education. Firstly, one could revert to the model used prior to 1998 and to fund all undergraduate education from taxation. Secondly, one could accept that, while taxation will need to fund a proportion of the costs (not necessarily as high as the 62 per cent met under the 2012 scheme), there is a clear ethical and financial case for a graduate contribution also to meet part of the cost.

5.3 While there will be some who will argue for the taxation option, it is difficult to see how in the post COVID-19 environment, one would win an argument to make more of the costs of undergraduate education a direct charge on the public purse. For 15 years, undergraduates have had to make a direct and visible contribution to the cost of their education. Ending this now seems highly unlikely to be seen as a top priority for public spending. The public mood is more likely to want to find a way of getting an increase in the 38 per cent of costs which are being met by graduates. It is likewise hard to see how leaders of UK (or English) universities, student bodies and think tanks could unite around this option. Accordingly, the rest of this paper will focus on setting out a way of providing a scheme based partly on funding from the public purse and partly from securing a graduate contribution which is more transparent and more effective than the individualised debt and loan repayment approach used in the 2012 scheme.

5.4 In the light of the discussion above, it seems reasonable to set the aims of a future scheme as: to produce a framework which will reduce the cost to the Exchequer; to reduce the burden on graduates who would otherwise be saddled with huge unrepayable debt; and to provide a fairer and more transparent way of handling student finance. It is possible to demonstrate that a framework based on a graduate contribution scheme can meet these aims.[21] This framework would continue to provide undergraduate education at no charge to the student while studying, but would thereafter require an affordable long-term contribution from each graduate to reduce the cost to the state. It ceases to rest on individual loans but instead pools the costs of undergraduate education and defrays some of the pooled cost through income-contingent graduate contributions. It allows the government to choose and flex the parameters which will determine the specific rate and duration of graduate contributions according to political, social and economic priorities. These will rightly be the subject of debate by the different political parties but the overall framework should be sufficiently flexible and robust to meet any outcome of such debate.

5.5 The ethical basis for a graduate contribution scheme is straightforward. It recognises that undergraduate education creates three distinct beneficiaries. The first and most obvious is the student, who gains a qualification and experience which are likely to lead to significantly increased earnings and quality of life. The second is the graduate's employers (and, indeed, employers more generally), who benefit from the skills and knowledge their employees have gained from higher education (and the ability to choose from a more valuable pool of labour). The third is society more generally, which benefits from the range of services provided (and higher taxes paid on average) by graduates. It therefore is reasonable to use broader taxation to fund higher education in the same way that it is used to fund the NHS and other public services provided that the graduate also makes a contribution through the Graduate Contribution Scheme.

5.6 The ethical basis is consistent with each of the interpretations of the purpose of graduate contributions discussed in 4.21. One can regard it as a contribution made by the graduate to reflect investment made by the state in her or his undergraduate education or as a contribution to the costs of educating the undergraduates currently studying when the contribution is made. One could even argue that it should reflect both the individual and altruistic elements.

5.7 Those graduates benefitting from the additional earnings which accrue to a graduate compared to a non-graduate would pay a contribution based on earnings and set at a fixed rate on any income above a specified salary level. Those who do not proceed to higher education would not be liable for the contribution.[22]

5.8 The graduate contribution scheme therefore recognises that the most direct beneficiary of the service provided – who has the opportunity to gain a higher education qualification, which is likely to lead to significantly higher-than-average salaries – is asked to contribute more if these higher earnings are actually received. This implies that contributions will be income-contingent and is, of course, exactly the way politicians and most people in higher education describe the current system to prospective students. It has, however, three very important differences to the current scheme.

- Firstly, there are no student debts or loans.
- Secondly, the requirement to contribute is levied income-contingently on all those graduates who earn above the median income.
- Thirdly, the new scheme breaks the implicit link between the cost of a student's higher education and the level of repayments which they will make as a graduate. Instead, the costs are pooled and shared more widely to reflect the range of beneficiaries. A graduate who goes on to very high earnings will pay additional contributions throughout their lifetime, which may exceed the cost of their individual higher education. This reflects both the high level of benefit

their degree has conferred on them and their ability to pay. A graduate who enters a caring profession and has far lower earnings will still make contributions but these will not in total cover the cost of their individual higher education. This reflects the lower level of benefit conferred on them by their degree (and the higher benefit to society). It also reflects their lessened ability to pay.

5.9 The many arguments for pooling contributions in this way were all made before the 2012 scheme was introduced. Aversion to new taxes and ideological reservations about the redistributive nature of pooling may well have reduced its attraction but, economically, one over-riding priority probably made its rejection inevitable anyway. At that time, the Government was absolutely determined to secure the reduction in Public Sector Net Borrowing which would be made through the loan scheme – even though this reduction included an assumption that loans would be fully repaid. For almost 10 years, this illusory benefit was retained but the 2019 Office for Budget Responsibility reports marked the end of that benefit. Moreover, the illusory gains accrued since 2012 have been more than wiped out by the new Office for Budget Responsibility's acceptance of the low level of debt repayment and the consequent 'adjustment' to Public Sector Net Borrowing.

5.10 However, when the illusory Public Sector Net Borrowing benefit is removed, the case against the graduate contribution scheme falls. Funding the same proportion as the 2012 scheme of the costs of providing higher education through a graduate contribution becomes no more or less attractive in Public Sector Net Borrowing terms. Moreover, it is a far more transparent way of collecting those costs. University funding would revert to the grant-based system which was in existence for the second half of the 20th century but with the addition of a graduate contribution scheme to reflect the benefit to graduates of their higher education. The percentage share borne by graduate contributions could be set at the same level as currently (38 per cent with a current RAB charge estimated by the Office for Budget Responsibility to be 62 per cent) or set at another level determined by the Government of the day. One of the benefits of the graduate contribution model is that it allows a much more open discussion to take place about the parameters of the scheme which would be used to determine the proportion of total costs recouped by the scheme, how progressively one would want the scheme to be organised and how widely one would want the scheme to be applied.

5.11 The key parameters for the scheme would be set on the basis of strategic political decisions as to who pays, how much they pay and for how long each will pay. Accordingly, for example, we might firstly wish to set the threshold salary for graduate contribution to be payable at around the level of the median wage. This is roughly the current threshold for graduate loan repayments but it would also convey the welcome message that nobody would pay any contribution until their salary was above the UK average. The main benefit to a graduate which justifies the contribution is the ability to have higher than average earnings and so it seems reasonable not to levy the contribution until that threshold has been reached. We might secondly argue that the graduate contribution should be payable throughout the lifetime of the graduate. After all, a salary benefit is likely to lead to a pension benefit and so the benefit does not cease after a specific period. In practice, of course, the actual amount of contributions levied would on average be far lower in retirement as earnings fall.[23] Section 6 looks at other parameters but, in practice, the decisions about the breadth of the scheme and the level of costs it would collect are far more easily addressed if one is no longer constrained by the concept of individualised debt.

5.12 The introduction of a graduate contribution scheme for those graduating in the future would be relatively straightforward in principle. Those starting a full-time undergraduate course in or after, say, September 2022 could automatically be exempt from loans and fees but would be subject to the graduate contribution scheme under which levies would start to be made in April 2026. There would however need to be careful consideration given to the detail of implementation and transition from previous schemes including, for example, conditions established for those dropping out of courses without completing them.

5.13 In summary, then, introducing a graduate contribution scheme would enable England to adopt a simple system of undergraduate finance not based on a fiscal illusion. It may also be of interest to the other parts of the UK. We briefly address the implementation and strategic issues in sections 6 and 7 respectively.

6. Graduate Contribution Scheme I – some options for implementation

6.1 There are a number of details of implementation which need to be carefully considered before any new scheme could be introduced. If one wanted merely to stop the next generation of students from being burdened with huge debts while simultaneously minimising the immediate effects of changing from a loan scheme to a graduate contribution scheme, one could continue to collect from each new graduate a contribution of 9 per cent of any earnings above the current threshold. For 83 per cent of graduates (those who would not have fully repaid their debt after 30 years under the current scheme), their payments would be unaffected. For the other 17 per cent, their initial payments would not change either. For all graduates, however, there would be no debts any more. On the other hand, the term of payment would be extended so that the cost to the state is reduced. However, this model seems unattractive except possibly as a stop gap while the new parameters are being determined.

6.2 Instead, if one wanted to introduce a more carefully considered graduate contribution scheme, it would be wise to start by setting some simple cost targets. In so doing, one must be aware of the lessons of the last 25 years. In 1997, Dearing (see endnote 8) sought only to cover about 25 per cent of costs in this way. In 2004, Alan Johnson sought to increase this to around 40 per cent. In 2012, Browne (and Osborne) tried to push this up to 70 per cent (if one accepts their original RAB estimate of 30 per cent) or far closer to 100 per cent (if one accepts the 'full repayment of loans' treatment used in the national accounts). All tried to do this without up-front payments and with an emphasis on affordability by making payments by graduates dependent on their income. The Office for Budget Responsibility reports show that none of these approaches managed to collect more than about 40 per cent of the total costs. A starting point for the future might be to target a 50 per cent cost recovery level which would explicitly recognise the benefit of a degree to the graduate but would also recognise the benefit to society of investing in its young people. There is nothing sacrosanct about 50 per cent but it is a simple way of signalling through an equal share of costs that the country recognises investment in higher education leads to benefits both for the individual and for wider society. It would also reduce the current cost to the state, while recognising pragmatically that it is probably the highest level we can realistically achieve in an affordable way.[24]

6.3 On the basis of the figures discussed in 5.11 above, it would be possible to achieve the 50 per cent target using a lifelong requirement for a graduate contribution set at around 6 per cent to 8 per cent of income in excess of an income threshold set at the current median income.[25] This would effectively use the additional revenue from the lifelong payment term for all graduates (with a particularly large increase in revenue from higher-paid graduates who would cease to benefit from having paid off their individualised debt) to drive down the current 9 per cent rate while still achieving the 50 per cent target. This would need to be costed carefully in the light of the post COVID-19 economic situation but would seem to be achievable and affordable. It would have the added benefit of making the graduate contribution under the new scheme lower than that currently experienced under the 2012 scheme but payable for a longer period (see endnote 24).

6.4 By flexing the parameters of the scheme, it would be possible to create a more progressive variant whereby a variable contribution rate was levied so that higher earning graduates would pay a higher rate and lower earning graduates a lower rate. Conversely, one could likewise opt for a more regressive variant, which would shift the burden of payment away from higher earners and towards lower earners (as Augar proposed) by putting a lifetime cap on the total contributions which any graduate could be required to pay. However, unless the cap was set far higher than Augar envisaged, it would be impossible to cut the rate from 9 per cent without underachieving the 50 per cent recovery target.

6.5 It may be worth observing here that, if there were a decision to introduce a graduate contribution scheme, it would be possible to consider whether those who were given free tuition fees and maintenance grants to get their degrees (like the current author!) could reasonably be expected to pay that graduate contribution. That, at a stroke, would enable a far higher percentage of the costs of higher education courses to be met by graduate contributions than could ever feasibly have been collected under the student loan scheme. It would also enable the costs to be shared much more fairly on an intergenerational basis. If, for example, detailed analysis found that a broadly based graduate contribution based on 5 per cent of income over the median would cover half the total cost of the provision of higher education, leaving the remainder to be met by general taxation, would this be an attractive post COVID-19 option? It would certainly reflect a fairer intergenerational distribution of costs than anything yet seen in the 21st century. However, this is rightly a matter for governments and interest groups to debate and determine. The graduate contribution framework at least makes that debate possible without needing to buy into fiscal illusions.[26]

6.6 Cohorts of students who graduated under the post-2012 student loan scheme could be allowed to switch to the new graduate contributions regime (with lower repayments but a longer contribution payment period) or to remain under the post-2012 scheme. Those graduating before then (or before the 1998 introduction of fees) could either be left unaffected or swept into the new arrangements if the Government decided to levy the graduate contributions on students who graduated prior to the loan scheme commencing.[27]

6.7 In summary, then, a graduate contribution scheme could be tailored to enable England to adopt a simple, more equitable system of undergraduate finance. Careful modelling and wide consultation on costing objectives and parameters would enable a financially sound and administratively efficient scheme to be developed and introduced. There remain, however, some strategic issues which are addressed in Section 7.

7. Graduate Contribution Scheme II – strategic issues

7.1 Despite the existence of the Office for Budget Responsibility's verdict on the scheme, it should not be assumed that it will be replaced in the near future. The flaws and the fiscal illusion will potentially make this a very toxic issue for any government to address as it would draw attention to a scheme introduced and retained 'on their watch' despite all its flaws. An Opposition which has made a clear argument for free tuition fees may not want to dilute its message at this stage in the electoral cycle by getting too close to the more detailed analysis of how higher education should be funded. With Brexit and the recovery from COVID-19 dominating all political thinking, dealing with student finance will not be a priority.

7.2 The higher education sector should however be very concerned about the scheme on which its funding is currently based. If the scheme is based on a fiscal illusion, so is student funding! This is not an easy subject for the sector to raise but the huge financial disparity between the claims of the scheme and its reality make it almost certain that at some stage, there will have to be a reckoning. The strategic choice for the sector is whether to keep quiet and await that reckoning or to take the initiative and launch a strong case for a transparent graduate contribution scheme as the fairest and most cost effective method of funding higher education. If Universities UK, the NUS and other higher education organisations (including trade unions) were to unite to pursue the graduate contribution option, it would be far easier for politicians to be persuaded this is the way forward. Conversely, if the sector pursues the 'do nothing' option, it is impossible to rule out a situation whereby the government decides at some stage (and, inevitably, in haste) to cut the unplanned cost of higher education revealed by the Office for Budget Responsibility. The adoption of much of the Browne report was rushed through in the climate of austerity that followed the 2008 financial crisis and it is easy to see a situation post COVID-19 where history could repeat itself. Cherry picking solely the cost-reducing features of Augar, coupled with savage cuts to student numbers or less economically-driven degree subjects, could inflict considerable damage on higher education institutions and their students. The best protection against such an outcome would be to have developed a clear, coherent strategy around which institutions and students can unite to promote investment in undergraduate education.

7.3 If a broadly based campaign led by Universities UK, NUS and education trades unions could be mounted, therefore, this may look like a win-win option to politicians. It would remove a system which has been shown to rest on a fiscal illusion. It would also remove the difficult problem of having a so-called student 'loan' scheme that is based on advances which can no longer legitimately be described as loans. It would enable student and university finance to be put on a cross-party basis in terms of a funding framework, leaving the parameters open for political determination without needing to reorganise the whole scheme. It would prevent some providers being tipped into bankruptcy from the pressures of COVID-19, Brexit and collapse of student demand. It may also be popular with voters!

7.4 Moreover, the 2012 scheme is not working well for any political party. The Conservatives reached a new low in terms of their support among voters under 35 in the 2019 general election and it is very difficult to see how they will reverse this while the student loan scheme continues to increase the number of voters burdened with impossibly high debts. Although Labour did well among the same age group in 2019, the simple message of 'abolish student fees' helped to create an impression of a party dependent on a 'magic money tree' that did so much to damage them electorally. The Liberal Democrats have not yet escaped the opprobrium that wiped out almost all their MPs in 2015, partly as a result of having supported the introduction of the £9,000 fee despite campaigning in the 2010 on a simple 'no fee' message. A new graduate contribution framework might therefore start to look very attractive to all parties. It would certainly fit well with a declaration of commitment to a high-skills economy for the future. It would also have a good chance of support in the devolved administrations of the other parts of the UK.

7.5 If Friday, 13 December 2019 was the best possible day to bury the Office for Budget Responsibility's verdict on the student loan scheme, the period immediately following COVID-19 might be the best time to find a long-term solution to university and student finance.

8. Conclusions

8.1 The Office for Budget Responsibility report of December 2019 makes clear that the current student loans scheme is based on the fiscal illusion that student debts will be fully repaid by graduates. Only 17 per cent of graduates are set to repay their debts in full and 62 per cent of all debt is set to be left unpaid after 30 years and will have to be written off by government. The benefits of the scheme in terms of Public Sector Net Borrowing are also illusory and have had to be reversed retrospectively and eliminated completely thereafter. The cost of the current student loan scheme exceeds that of the system it replaced. So, a scheme introduced to reduce the cost to the Exchequer has in fact increased it.

8.2 Although the findings of the Office for Budget Responsibility report are extremely significant, the flaws it identified have long been known by those who have looked carefully at the figures and were, in fact, widely predicted before the scheme was even introduced. The reasons why the scheme was introduced despite all its flaws and retained for so long can only be explained by the financial and political climate in place after the 2008 crisis and the unwillingness to lose the Public Sector Net Borrowing benefits that the scheme appeared to confer. These have been more than wiped out by the Office for Budget Responsibility report. The scheme therefore needs to be replaced.

8.3 There is now an opportunity for other methods of student and university finance to be considered. The most equitable and transparent system would be to abolish fees but to introduce a graduate contribution scheme. If the sector could unite around this approach, it would be far easier for this to become politically acceptable. If not, there is a danger that a need for quick cost-cutting will see the Government grasp other options such as slashing student numbers, increasing loan repayments or adopting the more regressive elements of the Augar report, thereby inflicting serious damage on prospective students and higher education institutions.

Endnotes

1 Office for Budget Responsibility (OBR), *Economic and fiscal outlook,* March 2019, Annex B, pp.183-194 https://cdn.obr.uk/March-2019_EFO_Web-Accessible.pdf and OBR, *Restated March 2019 forecast,* November 2019, https://obr.uk/docs/dlm_uploads/Restated_March_2019_forecast.pdf

2 Office for National Statistics, *New treatment of student loans in the public sector finances and national accounts*, 17 December 2018 https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/articles/newtreatmentofstudentloansinthepublicsectorfinancesandnationalaccounts/2018-12-17

3 For an example of the analysis available before the Student Loan Scheme came into force in 2012, see John Thompson and Bahram Bekhradnia, "*Higher Education: Students at the Heart of the System" – an Analysis of the Higher Education White Paper,* November 2010 and updated 17 August 2011. This paper, which set out in considerable detail the reasons why the RAB was certain to be far higher than the Government estimate, contains this prescient comment;

> *Unless the Government RAB estimates are challenged by the Office for Budget Responsibility or the Office for National Statistics, they will be used in National Accounts and the deficit reduction will occur 'on paper' whether or not the expected repayments are eventually made. If the RAB estimates are too low it will be the taxpayer who will have to make up the difference in the end, but that may not become clear for some time.*

'Some time' turned out to be over 8 years later when the OBR reports were published in 2019. https://www.hepi.ac.uk/wp-content/uploads/2014/02/White_paper_response_08_15c.pdf.

Bahram Bekhradnia (The then-Director and Founder of HEPI, already the most authoritative HE think tank in UK at that time) also gave evidence to the Business, Innovation and Skills Committee in 2011 and pointed out the seriously flawed estimate of the RAB. His arguments were endorsed by the Institute of Fiscal Studies at the committee. The report of the Committee's deliberations and the response of the Government are set out in the parliamentary record:

Business, Innovation and Skills Committee - Twelfth Report, *Government reform of Higher Education,* November 2011 https://publications.parliament.uk/pa/cm201012/cmselect/cmbis/885/88502.html

4 The difference between RAB figures varies a lot between different sources. Partly, this is a result of the volatility in estimates of outcomes which will not fully take place for 30 years. However, there is also more than one way to define the scope of the RAB. Using the average for all cohorts entering since 2012 gives a different result from an average for cohorts from 1998. The most valuable long-term estimate will be derived from estimating the RAB for the latest cohort for which data is fully available as this ensures that the average is based on the current regulations and not earlier versions which have been superseded. This is the approach used by the OBR to obtain the 62 per cent figure used throughout this paper. All evidence suggests that the economic effects of COVID-19 will push the OBR figure of 62 per cent upwards but the extent of that change is currently impossible to predict. The latest RAB estimate published by the Department for Education is 53 per cent. See https://explore-education-statistics.service.gov.uk/find-statistics/student-loan-forecasts-for-england/2019-20.

5 Eurostat letter to ONS dated 12 December 2018 and available as *Ex-ante advice on the recording of the UK student loans in Government Finance Statistics,* https://ec.europa.eu/eurostat/documents/1015035/8683865/Advice-2018-UK-Student-loan-recording.pdf/3b1b8268-12ff-4f18-a9f7-239b62f68a67

6 https://www.hepi.ac.uk/wp-content/uploads/2021/01/Appendix.docx

7 For more detail of developments in this era, see Nicholas Hillman, 'From Grants for All to Loans for All: Undergraduate Finance from the Implementation of the Anderson Report (1962) to the Implementation of the Browne Report (2012)', *Contemporary British History*, 2013, Vol 27, No 3, pp 249-270 https://www.tandfonline.com/doi/full/10.1080/13619462.2013.783418

8 *Higher Education in the learning society* – The Dearing Report (1997) http://www.educationengland.org.uk/documents/dearing1997/dearing1997.html

9 The Browne Report, *Securing a Sustainable Future for Higher Education: An Independent Review of Higher Education Funding & Student Finance*, October 2010 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/422565/bis-10-1208-securing-sustainable-higher-education-browne-report.pdf

10 See the online Appendix for more details. https://www.hepi.ac.uk/wp-content/uploads/2021/01/Appendix.docx

11 Philip Augar, *Independent panel report to the Review of Post-18 Education and Funding*, May 2019 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/805127/Review_of_post_18_education_and_funding.pdf

12 The student growth assumptions in the report are summarised on page 92 of the report as follows:

> *Following a decline in the total number of 18 year olds in the UK from a peak of 830,000 in 2009 to 766,000 in 2017, the number will start to increase again in 2020 and surpass 2009 levels by 2025. At current levels of participation and resource per student, these numbers will bring in approximately £500 million of annual extra income for universities by 2025 over current levels.*

13 The Augar panel estimate a 3 per cent increase in the state share on p178 of their report but we have treated this as approximately equal to the pre-Augar scheme for the purposes of this paper. Overall costs to the state would begin to rise from 2023/24 as the growth in student numbers commences (see endnote 12).

14 Augar goes beyond merely protecting higher paid graduates and significantly reduces their contribution, thereby wiping out the minor reduction in state funding which would otherwise have accrued from raising the contributions of low and middle earning graduates.

15 See the online Appendix for more details. https://www.hepi.ac.uk/wp-content/uploads/2021/01/Appendix.docx

16 Browne's recommendations raised the income threshold at which graduate repayments would commence, thereby reducing the level of each repayment made by a graduate. However, another recommendation lengthened the period of repayment to 30 years, thereby restoring some of the lost revenue. A further recommendation raised the interest rate on loans, but this had little effect on revenue and no effect on the total repayments of all but the highest paid graduates. For the rest, the extra interest just increased the amount written off by the state after 30 years. In summary, the overall effect of the Browne recommendations was to more than double the debt without increasing the overall level of repayments. Inevitably, this ensured that much of the student debt would never be repaid.

17 As we learnt from sub-prime mortgages in 2008, unaffordable payment levels are no solution either!

18 For any given number of undergraduates being educated at any given cost per undergraduate, the total cost of provision is not altered by the way in which graduate contribution is calculated or collected. Paying part of the unit cost to the host university (by a government grant), while leaving only the remainder as the fee to feed into the undergraduate loan, will reduce the level of the loan made compared to that which would have been generated by the 2012 scheme. Those graduates, who would otherwise have paid off their full loan under the 2012 scheme, will do so more quickly as a result of this reduced level of the loan. They will therefore find their total contributions reduced because of the reduced period during which they are making repayments. Likewise, there will be some graduates who would not have been able to repay the full loan under the 2012 scheme but who will be able to do so under the 'part-fee' system. They will thereafter cease to make repayments so will also find their total repayments reduced. Graduates whose repayments are inadequate to fully repay even their reduced loans will be unaffected by the change. However, the reductions in payments from the first two groups will still reduce the overall revenue collected by repayments. As a result, whenever a proportion of the total cost is met by grant, the revenue previously collectable under the 2012 scheme is reduced and, consequently, the state contribution inevitably rises.

19 Office for National Statistics, *Student loans in the public sector finances: a methodological guide,* January 2020 https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/methodologies/studentloansinthepublicsectorfinancesamethodologicalguide

20 No attempt has been made in this paper to consider the impact of the student loan book sales. Andrew McGettigan has written an excellent summary of some of the issues involved - and some of the curious accounting practices covering it in the 'Fiscal Illusions', *London Review of Books*, Vol.1, No.17, 12 September 2019 https://www.lrb.co.uk/the-paper/v41/n17/andrew-mcgettigan/fiscal-illusions.

21 Elsewhere, such a scheme is often called a graduate tax but it seems presumptuous to use such a term for a scheme involving payments which only a minority of graduates would be required to make. If, as discussed in paragraph 6.5, the rules governing payment were to be widened to include a much larger proportion of graduates, the term 'graduate tax' might be more appropriate.

22 There would need to be conditions established for those dropping out of undergraduate courses without graduating but these could be relatively straightforward. Likewise, there would need to be simple arrangements made for the contribution to be collected at a lower rate for those taking two-year degrees. In principle, it would be possible to treat part-time students in exactly the same way as full-time students with no upfront fees while studying and an income-contingent graduate contribution thereafter, but this alone would not address the urgent need to reverse the collapse of part-time higher education since 2012. See, for example, Anna Fazackerley, 'Part-time student numbers collapse by 56% in five years', *Guardian,* 2 May 2017 https://www.theguardian.com/education/2017/may/02/part-time-student-numbers-collapse-universities.

23 Augar recommended extending the liability for graduates from 30 years to 40 years but, in retaining the link to individual debt, it does so regressively. Those earning over £100,000 a year – typically enough to clear their debt within 30 years – would pay no more than under the current scheme whereas those earning a salary closer to (or less than) the average would be saddled with an extra 10 years of repayments. This effectively penalises those who have gained least from their

graduate status while protecting entirely those who have benefitted most. Having spoken to thousands of students, parents and university staff over the last 20 years about how best to fund higher education, I have never heard anyone argue for this. Conversely, I have rarely heard even the strongest supporters of abolishing student fees argue against graduates making a contribution to higher education costs. Invariably, this is qualified by the proviso that the repayment should be based on 'ability to pay'. This, of course, is the underlying principle of a graduate contribution or tax.

24 If there is one lesson that must surely be learnt from the experience of introducing the 2012 scheme, it is that whatever replaces it must be based on very careful analysis and estimation of future costs. In 2010, the Browne report overestimated the likely rise in graduate salaries which led to an overestimation of the revenue that would be brought in by the graduate loan repayments on the income-contingent basis used. The Government compounded that error by introducing a fees regime that would inevitably lead to average fees at least 20 per cent above the fee it had estimated, thereby hugely increasing the estimated debt level each student would face. In the national accounts, it then treated the student loans as if they met the official definition of a 'loan' (in 2.3) and would therefore be fully repaid. This effectively ignored not only the recognition by Browne and the Treasury that 30 per cent of the loans would need to be written off at maturity but also the overwhelming evidence that 50 per cent repayment was all that could be achieved and so 50 per cent of the loans would need to be written off. It would, therefore, be folly to attempt any future changes without details of costs being fully analysed and made available for review to ensure that the figures are robust. A starting point should be a clear identification of the target to be achieved. I have suggested a 50/50 split between state and graduate contribution funding over the longer term. Such a target would allow graduate contribution levels to be reassessed every five years, say, in the light of experience and projections. In this paper, there are some hypothetical options put forward based on some broad-brush calculations and my experience of assessing other schemes as they have been proposed and / or implemented over the last 25 years. They are not fully costed or modelled but provide some idea of what a graduate contribution / tax might achieve.

25 Any estimate of incomes in the mid-2050s and beyond (before and after retirement) of those graduating after the mid-2020s needs to allow for forecasting errors but the contribution from many graduates after the age of 50 is likely to be higher than the pre-50 contribution even in real terms.

26 Some would argue that the broadening of the scheme to levy contributions from past graduates would be an example of retrospective legislation or taxation but this may look very much like special pleading to those who have graduated since 2015 and found themselves burdened with debts of £40,000 or more as a result. They might argue that beginning to take a contribution now from those who received their university education free of charge decades ago is 'better late than never'. Those who graduated in the mid-1970s when the top rate of income tax was 83 per cent and the standard rate 33 per cent certainly expected to pay tax at those rates. The comparable rates now are 45 per cent and 20 per cent respectively. The amount of income tax which they have paid over the last 45 years is therefore substantially below those expectations. These tax reductions were partly funded by the increased revenue from later graduates. Any graduate contribution which they may pay in future would cost them a tiny fraction of the income tax reductions from which they have benefitted.

27 With a wider levy for the graduate contribution, special arrangements would be needed those who were subject to previous fee and loan systems involving fees of £1,000 or £3,000 a year. These might be granted some form of partial exemption from the levy to reflect repayments already made.

Student funding remains hotly contested. In this HEPI Debate Paper, Alan Roff examines the findings of the Office for Budget Responsibility, which regards the past treatment of student loans in the national accounts as a 'fiscal illusion'. Roff explores the consequences of this change of heart and pushes for an alternative approach to student finance based on a new graduation contribution scheme.

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